COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts	))))))	**D.T.E. 01-31**

REPLY BRIEF OF THE ATTORNEY GENERAL

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I. INTRODUCTION

Pursuant to the procedural schedule issued by the Hearing Officer, the Attorney General files this Reply Brief for the purpose of responding to arguments made in the Initial Brief submitted by Verizon Massachusetts ("VZ-MA," "Verizon" or "Company"). The Attorney General reiterates his position that pricing flexibility is not warranted and that the Department should not allow Verizon to depart from a traditional cost-of-service or indexed price cap form of regulation in the residential or business markets.

This reply brief is not intended to respond to every argument made or position taken by Verizon. Rather, it is intended to respond only to the extent necessary to assist the Department of Telecommunications and Energy ("Department" or "DTE") in its deliberations, *i.e.*, to provide further information, to correct misstatements or misinterpretations, or to provide omitted context. Therefore, silence by the Attorney General in regard to any particular argument, assertions of fact, or statement of

position in Verizon's brief should not be interpreted, construed, or treated as assent, acquiescence or agreement with such argument, assertion or position.

II. ARGUMENT

A. THE COMPANY'S ARGUMENTS REGARDING COMPETITION AND CLEC MARKET SHARE IN MASSACHUSETTS ARE WITHOUT MERIT

The Company argues that there is a "significant level of competitive activity,"and that "there is intense competition across all segments of the business market." Verizon Brief, p. 24, 30. However, the record evidence demonstrates that business competition is limited to a few wire centers and that residential competition is virtually non-existent. Verizon has failed to demonstrate that it lacks market power in most areas of the Commonwealth. While there is clearly a move toward competition and a competitive market, the evidence demonstrates that it is premature to allow Verizon the pricing freedom it requests. There is not "sufficient competition" at this time for the Department to conclude that either the residential or business markets are "fully competitive." Given the market power Verizon currently holds, telephone rates set by the market fail to satisfy the "just and reasonable" requirements of G.L. c. 159, § 17.

1. VERIZON'S WIRE CENTER ANALYSIS IS INAPPROPRIATE

In its Brief, the Company has commingled its analyses of the business and residential markets, essentially treating the two markets as though they were one. The Company made no attempt to distinguish between the business and the residential markets regarding supply elasticity, demand elasticity, or market share. Without these separate market analyses, the Company has failed to meet the Department's first test in its determination of the sufficiency of competition, the delineation of the

appropriate market at issue. *Petition of AT&T Communications of New England*, D.P.U. 91-79, Order (June 22, 1992) at 31.

2. THERE IS LITTLE EVIDENCE OF COMPETITION

Contrary to the Company's claim that there is "intense" competition across the state in all markets, the evidence clearly demonstrates that the Company commands 92 percent statewide of the residential market. Verizon Brief, p. 14; RR DTE-VZ-2. The evidence also demonstrates that the Company still controls at least 58 percent statewide of the business market, a market share higher than that which the Department found to be necessary to meet its test of "sufficiently competitive" in D.P.U. 91-79. RR DTE-VZ-2. Although the business market may be nearing a state of "sufficiently" competitive in some wire centers, it is clear that the residential market is not even remotely competitive on a standalone basis.

In its Brief, the Company attempts to bolster its assertions about competition with information concerning the level of competition aggregated by density zone and purporting to show that some zones are more competitive than others. Verizon Brief, pp. 14-15 (Tables 3, 4, and 5). The information in Tables 3, 4, and 5, however, merely underscores the low competitive levels for the business market in all but the metropolitan zone, which contains just four wire centers. Verizon still owns more than 91 percent of the residential market and more than 62 percent of the total business market, still much greater than the 58 percent market share that the Department found was too high a share to have "sufficient" competition. AG Brief, p. 13; *AT&T Communications*, D.P.U. 90-133, Order (January 2, 1991) at 2, fn.2, and at 39.

3. THE EVIDENCE DEMONSTRATES THAT VERIZON EXERCISES MARKET

POWER IN MOST IF NOT ALL WIRE CENTERS

In its Brief, Verizon dismisses the Attorney General's request that the Department conduct its analysis of Verizon's market power by wire center. Verizon Brief, p. 22 (asserting there is no value in the proposals). Verizon, however, cannot deny the value to the Department of seeing, with some precision, where competition is actually occurring and where competition is notably absent. The wire center data presented in the Company's Profile gives just that view and reveals that competition is not occurring at the same pace throughout the state, throughout each area code, or even throughout each density zone. Since competition is developing at such an uneven pace, the Department must protect customers from the potential that Verizon will exercise market power in those non-competitive areas of the Commonwealth. That protection can only be given through rate regulation – either cost-of-service or indexed price cap – because there is not sufficient competition to insure that Verizon's market-based rates would be just and reasonable.

Although Verizon contends that the estimate of CLEC lines underestimates the measure of CLEC market share based on revenues in any given wire center (Verizon Brief, p.14, fn. 17; Exh. VZ-5A at 15), the Company failed to support this bare assertion with any data. Verizon did not produce any evidence regarding the revenues generated by CLECs. Indeed, the only evidence of revenues on the record is information provided by the Attorney General – the total operating revenues for 2000 for Verizon (over $3 billion), for RCN Telecom of Massachusetts (zero dollars), and for several other CLECs who had no revenues for Massachusetts in 2000. Exhs. AG-11 and AG-20; AG Brief, p. 15, fn. 15. The Department cannot, therefore, accord any weight to Verizon's correlation of revenues as a measurement of market share.

Finally, Verizon's UNE-P figures indicate that its UNE-P prices may be creating barriers to entry in the local residential market by preventing competitors from competing using UNEs. Verizon's UNE access line information demonstrates that competition for residential customers through the UNE mode of entry has actually declined from 8,000 UNE customers in October 2000 to 7,000 UNE customers in December 2001. Verizon Brief, p. 13, Table 1. If UNE prices were not creating a barrier to entry, one would expect those figures to increase rather than decrease.

4. VERIZON'S CLEC ASSET TURNOVER ASSUMPTION IS ERRONEOUS

Verizon also contends that the assets of CLECs who file for bankruptcy remain in the competitive market and are reused by other CLECs. Verizon Brief, p. 14; Exh. VZ-4 at 10. However, current dockets before the Department, *Broadview Networks*, D.T.E. 02-14, and *Network Plus*, D.T.E. 02-15, demonstrate that CLEC customers and CLEC assets may dissipate or may flow to Verizon through bankruptcy proceedings such that CLEC assets no longer serve as a competitive force against Verizon's market power. There is no evidence in this docket that shows where all the CLEC customers or assets have migrated. The Department should reject Verizon's arguments concerning bankrupt CLECs.

5. VERIZON'S NUMBERS IN THE E911 DATA BASE ARE UNRELIABLE

Verizon attempts to use the E911 database to support its contentions about competition, but without evidence that there is uniform compliance with the reporting standards for this data, the reliability and accuracy of the E911 database *as a measure of competition* is open to question. Verizon's reliance on the E911 database to estimate the number of competitive lines inflates the true number of CLEC lines. As the testimony of Verizon witness Mr. Conroy demonstrates, AT&T

submitted its E911 data to Verizon using standards that differ from those used by Verizon. Tr. 2, at 158-159. If AT&T were reporting its E911 data differently, the Department can reasonably infer that it is likely that other CLECs have different reporting standards. The E911 database, therefore, is not a reliable indicator of competition in the market. Tr. 1, at 131.

B. THEORETICAL COMPETITION IS NOT REAL COMPETITION

Verizon maintains that since CLECs have the legal ability to enter the market, then "regardless of its current market share, Verizon MA has no significant market power. . . ." Verizon Brief, p. 11.[1] There is a significant distinction between the legal ability to enter a market and entry as a meaningful economic force in the market. Tr. 1, at 138. Theoretical competition is not necessarily the same as real competition, so the Department must distinguish the two standards clearly.[2] *See InterLATA Competition Order*, D.P.U. 1731, pp. 55-56 (October 18, 1985) (The degree of regulation in each market segment depends on the present competition and "a danger exists if the Department moves to reduce the degree of regulation before sufficient competitive forces are present in a market.").

The recent bankruptcies of a number of CLECs demonstrate the fallacy of Verizon's arguments. In addition, the Department has not completed its investigation into the Verizon UNE docket, D.T.E. 01-20. It is premature to conclude that the legal ability to enter a market will equate to

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[1] Verizon devotes a considerable portion of its initial brief simply to asserting that the litmus test for market power should be the existence of barriers to entry, as if Verizon could prove this theory by sheer repetition, rather than with objective evidence from the proceedings.

[2] The Department recognized the need to measure competition actually present when determining the method of regulation in its *IntraLATA Competition Order*, D.P.U. 1731: "The degree of regulation that should apply to a particular market should reflect the degree of competition present." *Id*. at 45.

actual competition. The Department should determine that actual, not theoretical, competition will result in just and reasonable rates for customers.[3]

C. PAYPHONE COMPETITION IS INSUFFICIENT TO COUNTER VERIZON'S MARKET POWER

The New England Public Communications Council correctly notes that there is no showing on the record of any meaningful competition to Verizon's Public Access Line ("PAL") or Public Access Smart-pay Line ("PASL") services. NEPCC Brief, p. 2. Verizon's reliance on theoretical competition for PAL and PASL is misplaced and, as with other residential and business services, cannot serve as the foundation for an award of pricing flexibility. Verizon controls access to the PAL and PASL services. The Attorney General's analysis in his Initial Brief regarding the inability of resellers to compete using Verizon's bottleneck resold facilities applies equally to the payphone sector. AG Brief, p. 17-18. The record evidence demonstrates that even the largest PAL competitors within NEPCC cannot control pricing decisions made by Verizon absent oversight by regulated rates. Verizon claims that "resale competition is also thriving" (Verizon Brief, p. 18), but resale of PAL and PASL constitutes a minuscule fraction of the total number of access lines and, consequently, cannot exert meaningful market pressure on Verizon's control over the payphone sector. *See* Exh. NEPCC-VZ-2-6A (Proprietary), Exh. NEPCC-VZ-3-1A (Proprietary).

The only control in place is the ability of the Department and parties to review and challenge

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[3] Verizon puts great significance on the observation that few CLECs chose to intervene in this docket. Verizon Brief, p. 22. Without a scintilla of evidence, the Company speculates that the CLECs chose not to participate in order to hide their competitive activity. If the Department wants to consider the absence of the CLECs in this processes, perhaps poor market conditions and the need to devote scarce resources elsewhere as part of a struggle to survive provide more plausible explanations for the CLECs' behavior.

tariff changes to PAL, PASL, and other services that Verizon may propose. Exh. NEPCC-VZ-1-1. There is no provision in Verizon's Plan (Exh. AG-21) that requires the Company to send proposed modifications of its tariffs to the NEPCC, the Attorney General, or interested parties; consequently, this "remedy" will be overlooked too easily and must be corrected by regulatory action. At a minimum, the Department must order Verizon to submit all proposed tariff changes to the Attorney General and all proposed PAL and PASL tariff modifications to NEPCC simultaneous with their submission to the Department.

D. THE DEPARTMENT SHOULD CONSIDER UNIFORM STATE-WIDE RATES RATHER THAN CAPPED RATES

In its Brief, the Company responded to a number of questions raised by Commissioner Vasington during hearings. Commissioner Vasington was rightly concerned about the lack of competition in certain geographic areas when he raised the issue of a "cap" on prices in "less-competitive areas." Rather than addressing the Commissioner's questions, the Company merely repeated its familiar refrain that the evidence warrants granting Verizon pricing flexibility in all parts of the state.

As Commissioner Vasington correctly noted, the evidence in this case demonstrates that there is a lack of competition, especially outside the Route 128 area. Rather than embark on a time consuming examination to determine the loop cost of service, the Attorney General recommends that, if Verizon is given pricing flexibility for any business customers, the Department should consider requiring uniform state-wide rates and deny Verizon the ability to geographically deaverage its business rates.

The business rates should remain the same no matter where the consumer lives in the state.[4] If state-wide rates are charged, those customers outside the Route 128 area will benefit from lower market based rates charged to customers inside Route 128. The benefits of competition will flow to all customers, instead of just to customers in the few wire centers where competition arguably may exist.

E. VERIZON HAS NOT PROVEN THAT THE PAP IS EFFECTIVE

The Department cannot accurately evaluate the effectiveness of the Performance Assurance Plan ("PAP") until the PAP audit is complete. In reviewing the audit, the Department should examine whether the PAP penalties are a sufficient economic disincentive to prevent anticompetitive "backsliding" by Verizon toward its wholesale customers. There is no information in the record regarding the effect of the 2-4 month delay imposed on CLECs in receiving the PAP penalties owed them by Verizon. Finally, the PAP audit process must become more transparent to be reliable. AG Brief, pp. 21-28.

In its brief, Verizon attempts to use a theoretical construct to support its assertions that the PAP is effective. The Department must take its own fresh look at the information that will come from the PAP audit before concluding that CLECs can rely on the PAP to detect, deter, and remedy Verizon's substandard wholesale performance. Although Verizon contends that the fact that PAP monthly penalties have decreased over the past year shows improved wholesale performance (Verizon Brief, p. 28), Verizon has demonstrated no proof of the connection between the two. Verizon would like the Department to make a "leap of faith" in creating a causal connection, even though an equally rational

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[4] There is little if any evidence in the record to support a cap other than at the most competitive rate. Tr. 4, at 733-734.

explanation is that Verizon is paying fewer penalties because *there are fewer CLECs available to whom Verizon can give substandard performance*.

The evidence necessary to judge the PAP is not in the record. The reason for the decline in penalties should become apparent through the audit process, but the Department cannot make an informed judgment, based on actual evidence, about the PAP's effectiveness until the PAP audit is complete.

III. CONCLUSION

The Attorney General requests that the Department deny Verizon's premature petition for pricing flexibility for all residential and business retail services in the local retail market. Verizon has failed to establish that there currently is sufficient competition and lack of Company market power throughout Massachusetts. Telephone rates set by the market at this time, therefore, will not will result in "just and reasonable" residential and business rates required by G.L. c. 159, § 17.

Respectfully submitted

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding by e-mail and either hand-delivery or U.S. mail.

Dated at Boston this 28th day of February 2002.

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